



**Community Health Network, Inc.  
and Affiliates**

**Consolidated Financial Statements  
December 31, 2008 and 2007**

# Community Health Network, Inc. and Affiliates

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## **Report of Independent Auditors**

To the Board of Directors of  
Community Health Network, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations and changes in net assets and cash flows present fairly, in all material respects, the financial position of Community Health Network, Inc. and Affiliates (the "Network") at December 31, 2008 and 2007, and the results of their operations, changes in their net assets and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Network's management. Our responsibility is to express opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 8 to the consolidated financial statements, the Network changed the manner in which it accounts for defined benefit and other postretirement benefit plans at December 31, 2007.

*PricewaterhouseCoopers LLP*

May 15, 2009

**Community Health Network, Inc. and Affiliates**  
**Consolidated Balance Sheets (in 000's)**  
**December 31, 2008 and 2007**

	2008	2007
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 67,549	\$ 96,829
Restricted cash	9,800	-
Patient accounts receivable, less allowance for doubtful accounts and contractual adjustments of \$284,098 and \$259,090 in 2008 and 2007	156,939	156,353
Estimated third-party payor settlements	1,634	7,909
Assets limited as to use—held by trustee	7,899	9,439
Inventories	16,785	14,480
Other accounts receivable	26,077	22,982
Other current assets	15,423	10,308
Total current assets	302,106	318,300
Assets limited as to use		
Funds held by trustee, net of current portion	13,885	13,639
Board-designated funds	243,402	353,076
Reinsurance trust assets	12,088	11,934
Property, plant and equipment, net	586,867	545,446
Investments in unconsolidated affiliates	24,881	25,924
Intangible assets, net of accumulated amortization	7,113	7,574
Prepaid pension and postretirement assets	1,555	22,253
Other assets	6,504	6,516
Total assets	<u>\$ 1,198,401</u>	<u>\$ 1,304,662</u>
<b>Liabilities and net assets</b>		
Current liabilities		
Short-term borrowings	\$ 27,800	\$ 13,500
Current portion of long-term debt	13,658	15,666
Accounts payable	52,778	33,351
Accrued salaries and wages	28,727	38,646
Accrued interest	3,349	3,874
Estimated third-party payor settlements	7,611	1,905
Incurred but not reported liabilities	26,690	33,184
Other current liabilities	9,172	12,006
Total current liabilities	169,785	152,132
Accrued postretirement benefit cost	3,598	3,269
Accrued pension	59,415	42,799
Due to unconsolidated affiliates and related parties, net	14,708	16,712
Long-term debt, net of current portion	359,497	372,999
Pension underfunded liability- long-term	106,643	-
Other liabilities	2,453	2,742
Total liabilities	716,099	590,653
Minority interest	14,729	12,633
Net assets		
Unrestricted	459,154	692,643
Temporarily restricted	4,387	4,726
Permanently restricted	4,032	4,007
Total net assets	467,573	701,376
Total liabilities and net assets	<u>\$ 1,198,401</u>	<u>\$ 1,304,662</u>

The accompanying notes are an integral part of these financial statements.

**Community Health Network, Inc. and Affiliates**  
**Consolidated Statements of Operations and Changes in Net Assets (in 000's)**  
**December 31, 2008 and 2007**

	2008	2007
<b>Change in unrestricted net assets</b>		
Revenues and gains		
Net patient service revenue	\$ 1,080,485	\$ 1,006,021
Managed care risk revenue, net	(2,932)	37,915
Service fee revenue	26,709	26,306
Other revenue	85,301	86,092
Equity in earnings of unconsolidated affiliates	15,102	14,694
Total unrestricted revenues and gains	<u>1,204,665</u>	<u>1,171,028</u>
Operating expenses		
Salaries and benefits	560,023	518,215
Supplies and other expenses	487,716	446,400
Health service claims expense	377	43,102
Depreciation and amortization	57,570	55,732
Provision for bad debts	54,173	55,335
Interest and financing costs	15,946	19,714
Total operating expenses	<u>1,175,805</u>	<u>1,138,498</u>
Income from operations	28,860	32,530
Investment (loss) income- realized/unrealized	(114,965)	25,792
Net cumulative unrealized gains transferred to trading securities	-	29,599
Minority interest in affiliates	(7,577)	(6,633)
Other, net	<u>(130)</u>	<u>(74)</u>
Excess (deficiency) of revenues over (under) expenses and minority interests before income taxes	(93,812)	81,214
Provision for income taxes	6,805	5,711
Excess (deficiency) of revenues over (under) expenses	<u>\$ (100,617)</u>	<u>\$ 75,503</u>

The accompanying notes are an integral part of these financial statements.

**Community Health Network, Inc. and Affiliates**  
**Consolidated Statements of Operations and Changes in Net Assets (in 000's)**  
**December 31, 2008 and 2007**

	2008	2007
<b>Change in unrestricted net assets</b>		
Excess (deficiency) of revenues over (under) expenses	\$ (100,617)	\$ 75,503
Adoption of SFAS No. 158- prepaid pension and postretirement assets	-	22,253
Adoption of SFAS No. 158- measurement date provisions	(3,399)	-
Under funding of pension assets	(127,342)	-
Change in net unrealized investment gains and losses on other than trading securities and other changes	(2,131)	(586)
Net cumulative unrealized gains transferred to trading securities	-	(29,599)
(Decrease) increase in unrestricted net assets	<u>(233,489)</u>	<u>67,571</u>
<b>Change in temporarily restricted net assets</b>		
Restricted contributions received	724	1,359
Net assets released from restrictions	(1,453)	(1,679)
Investment income	390	308
Decrease in temporarily restricted net assets	<u>(339)</u>	<u>(12)</u>
<b>Change in permanently restricted net assets</b>		
Restricted contributions received	94	16
Other	(69)	13
Increase in permanently restricted net assets	<u>25</u>	<u>29</u>
(Decrease) increase in net assets	<u>(233,803)</u>	<u>67,588</u>
Net assets, beginning of year	<u>701,376</u>	<u>633,788</u>
Net assets, end of year	<u>\$ 467,573</u>	<u>\$ 701,376</u>

The accompanying notes are an integral part of these financial statements.

**Community Health Network, Inc. and Affiliates**  
**Consolidated Statements of Cash Flows (in 000's)**  
**December 31, 2008 and 2007**

	2008	2007
<b>Cash flows from operating activities</b>		
(Decrease) increase in net assets	\$ (233,803)	\$ 67,588
Adjustments to reconcile increase in net assets to net cash provided by operating activities		
Depreciation and amortization	57,570	55,732
Provision for bad debts	54,173	55,335
Deferred tax benefit (expense)	(1,360)	1,074
Equity in earnings of unconsolidated affiliates	(15,102)	(14,694)
Distributions received from unconsolidated affiliates	17,492	14,400
Change in prepaid pension cost	16,616	12,145
Investment income received	(1,350)	(12,433)
Other adjustments	2,187	3,038
Changes in operating assets and liabilities		
Patient accounts receivable	(54,759)	(74,513)
Other assets	11,664	(27,200)
Accounts payable	10,933	(7,380)
Estimated third-party payor settlements	11,981	(2,106)
Other liabilities	86,911	16,197
Net cash (used in) provided by operating activities	<u>(36,847)</u>	<u>87,183</u>
<b>Cash flows from investing activities</b>		
Acquisitions of property, plant and equipment	(78,922)	(47,730)
Acquisition of property, plant and equipment—South Expansion	(12,014)	-
Acquisitions of property, plant and equipment—North Expansion	-	(46,149)
Proceeds from sale (purchase of) property, plant and equipment	700	1,916
(Purchases)/sales of investments, net	112,318	(32,171)
Investments in unconsolidated affiliates	(1,347)	(2,829)
Distributions received from unconsolidated affiliates	-	419
Due (to) from unconsolidated affiliates and related parties, net	(2,004)	6,422
Net cash provided by (used in) investing activities	<u>18,731</u>	<u>(120,122)</u>
<b>Cash flows from financing activities</b>		
Proceeds from issuance of debt	14,300	-
Repayments of debt	(15,510)	(13,384)
Changes in restricted contributions and investment income	(9,954)	(2,034)
Cash flows used in financing activities	<u>(11,164)</u>	<u>(15,418)</u>
Net decrease in cash and cash equivalents	(29,280)	(48,357)
Cash and cash equivalents, beginning of year	96,829	145,186
Cash and cash equivalents, end of year	<u>\$ 67,549</u>	<u>\$ 96,829</u>
<b>Supplemental disclosures of cash flow information</b>		
Cash paid during the year for		
Interest	<u>\$ 17,811</u>	<u>\$ 20,525</u>
Income taxes	<u>\$ 6,858</u>	<u>\$ 4,126</u>
Acquisition of property, plant and equipment included in accounts payable at December 31	<u>\$ 11,502</u>	<u>\$ 3,008</u>

The accompanying notes are an integral part of these financial statements.

# **Community Health Network, Inc. and Affiliates**

## **Notes to Consolidated Financial Statements (in 000's)**

### **December 31, 2008 and 2007**

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#### **1. Organization and Summary of Significant Accounting Policies**

##### **Organization**

Community Health Network, Inc., an Indiana non-profit corporation and its non-profit and for-profit affiliates (collectively the "Network") comprise a full-service integrated health delivery system in central Indiana. The Network operates four acute care hospitals as well as a specialty hospital, five immediate care centers, a primary care physician organization, forty ambulatory care centers, twelve freestanding surgery centers, four outpatient imaging centers, two ambulatory endoscopy centers, four nursing homes and an assisted living facility. Effective January 1, 2007, Community Health Network, Inc., a dormant shell company, became the parent company and main governing body of the Network replacing Community Hospitals of Indiana, Inc. as the primary governing body. This change in governing body had no impact on the consolidated financial statements other than the name.

##### **Basis of Presentation and Consolidation**

The accompanying consolidated financial statements were prepared in accordance with generally accepted accounting principles in the United States of America ("U.S. GAAP") and include the assets, liabilities, revenues and expenses of all wholly owned subsidiaries, majority owned subsidiaries and when applicable, entities for which the Network has a controlling interest.

The consolidated financial statements include the following wholly owned entities:

- Community Hospitals of Indiana, Inc. ("Community"), a non-profit corporation which operates two acute care hospital facilities on the northeast and eastern sides of Indianapolis;
- Community Hospital South, Inc. ("CHS"), a non-profit corporation which operates an acute care hospital facility on the south side of Indianapolis; Community and CHS are collectively referred to as ("CHI");
- Community Hospitals of Anderson and Madison County, Inc. ("CHA"), a non-profit corporation which provides acute health care services to residents of Anderson, Indiana and surrounding communities;
- Community Physicians of Indiana, Inc. ("CPI"), a non-profit corporation which employs the Network's primary care physicians;
- Community Health Network Foundation, Inc. ("Foundation"), a non-profit corporation established to raise and expend funds for the benefit of CHI and other related organizations;
- Visionary Enterprises, Inc. ("VEI"), a taxable, for-profit subsidiary of the Foundation, whose operations consist primarily of ambulatory surgery center development, and management and other consulting services; North Campus Surgery Center, LLC ("NCSC"), which performs outpatient surgeries for certain patients of Community; VEI Michigan, Inc. has a 60% ownership interest in Michigan Surgery Investment, LLC ("MSI"), which holds ownership interests in six surgery centers located in Michigan.
- Community Home Health Services, Inc. ("CHHS"), a non-profit corporation whose operations consist primarily of providing home health care and hospice services to patients in thirteen central Indiana counties;
- Indiana ProHealth Network, Inc. ("ProHealth"), a provider association consisting of physicians and hospital members in central Indiana and the primary vehicle by which the Network contracts for risk with payors.



# **Community Health Network, Inc. and Affiliates**

## **Notes to Consolidated Financial Statements (in 000's)**

### **December 31, 2008 and 2007**

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In addition, the Network consolidates its interest in the Indiana Heart Hospital, LLC ("IHH"), a for-profit hospital specializing in cardiac care, South Campus Surgery Center, LLC ("SCSC"), Community Business Innovations, Inc. ("CBI"), Community Health Services, Inc., Long-Term Care ("LTC"), and Community Health Network Assurance Company, Ltd. ("Captive"). Effective January 1, 2009, CHI purchased the remaining units of IHH and became the sole member of IHH. Additionally, effective January 1, 2009, IHH became a non-profit corporation. IHH now operates under the name of Community Heart and Vascular. Community Heart and Vascular provides cardiac care at all CHI facilities as well IHH.

The Captive is wholly owned by CHI and reinsures a primary hospital professional liability policy including doctor's professional liability as well as a general liability policy. The professional liability policy is on a claims made basis and includes prior acts coverage for various entities owned by the Network, while the general liability policy is on an occurrence basis. On an annual basis, the Captive's ceding insurer requires the Captive to maintain an outstanding letter of credit to address any potential exposure between premiums paid and expected losses. As of December 31, 2007, the outstanding letter of credit was \$2,005 and expired March 1, 2008. Due to favorable claims experience and adequate funding, the fronting company did not require a letter of credit for the policy years beginning March 1, 2008 and March 1, 2009.

Significant intercompany accounts and transactions have been eliminated.

#### **Use of Estimates in the Preparation of Financial Statements**

The preparation of the consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates and assumptions are used for, but not limited to: (a) allowance for contractual revenue adjustments, (b) allowance for doubtful accounts; (c) depreciation lives of long-lived assets and (d) reserves for professional, workers' compensation and comprehensive general insurance liabilities risk. Future events and their effects cannot be predicated with certainty; accordingly the accounting estimates require the exercise of judgment. The accounting estimates used in the preparation of the consolidated financial statements will change as new events occur, as more experience is acquired, as additional information is obtained and as our operating environment changes. The Network evaluates and updates its assumptions and estimates on an ongoing basis and may employ outside experts to assist in its evaluation, as considered necessary. Actual results could differ from those estimates.

#### **Reclassifications**

Certain reclassifications have been made to the 2007 financial statements to conform to the 2008 presentation.

#### **Cash and Cash Equivalents**

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks and funds invested temporarily in money market accounts that are purchased with original maturities of three months or less.

The Network has entered into overnight sweep transaction agreements to purchase and resell direct obligations of, or obligations that are insured as to principal and interest by, U.S. Government agencies. At December 31, 2008 and 2007, cash and cash equivalents include \$22,763 and \$55,547, respectively, of overnight sweep transaction agreements.

# **Community Health Network, Inc. and Affiliates**

## **Notes to Consolidated Financial Statements (in 000's)**

### **December 31, 2008 and 2007**

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#### **Restricted Cash**

As of December 31, 2008, CHI has restricted cash of \$9,800 related to collateral calls on its 1995 Series debt. The monies are held in a separate cash account and can only be used to fund the collateral call requirements issued by the bank. As the fair value of the debt outstanding increases, the monies are released by the bank into the CHI's operating cash account.

#### **Inventories**

Inventories consist primarily of medical and surgical supplies and pharmaceuticals. All inventories are valued at the lower-of-cost or market. Cost is determined by the Network using a weighted average cost method, which approximates cost under the first-in, first-out method.

#### **Assets Limited as to Use**

Assets limited as to use consist of cash and cash equivalents, U.S. Government obligations, corporate bonds, and marketable equity securities, and are stated at fair value. The fair values of these investments are based on quoted market prices.

Effective January 1, 2007, the Network elected to transfer its Board designated investments in equity securities with readily determinable fair values and investments in debt securities from an "available-for-sale" classification to a "trading securities" classification. After reassessment, management determined transferring investments to the trading securities category is appropriate based on the Network's investment strategy and investment philosophies as investment managers may execute purchases and sales of investments without prior approval of Network management. While the Network's net assets were not impacted by this change in classification, the 2007 excess revenues over expenses and minority interests includes the recognition of \$29,599 of cumulative unrealized net gains and losses from prior years. In future periods, all unrestricted unrealized holding gains and losses are recorded in investment income in the period in which they occur.

Prior to January 1, 2007, the Foundation recorded its realized gains or losses on board designated funds in other operating revenue. Effective January 1, 2007, the Foundation has reclassified its mark to market adjustments as well as its realized gains or losses on board designated funds to investment income, net to be consistent with the approach taken by the other Network entities. The Foundation's investment income, net on board designated funds for the year ended December 31, 2007 was \$3,426.

Reinsurance trust assets are maintained by the Captive. Prior to January 1, 2007, these trust assets were classified as available for sale as defined in Statement of Financial Accounting Standards ("SFAS") No. 115 and were carried at fair value with unrealized gains or losses being reported in unrestricted net assets. Effective January 1, 2007, the reinsurance trust assets were reclassified as trading securities. This reclassification was made to make the financial statement presentation consistent with the Network's presentation. As such, realized and unrealized gains or losses are recorded in income versus other comprehensive income. For reinsurance trust assets, fair value is determined as described in Note 3. Realized gains and losses on sales of investments are determined using the specific identification cost method and are included in excess of revenues over expenses.

#### **Property, Plant and Equipment**

Property, plant and equipment are recorded at cost or, if donated, at the fair value at date of donation. Assets under capital lease obligations are recorded at the present value of the aggregate future minimum lease payments at the beginning of the lease term. For financial statement purposes, the Network primarily uses the straight-line method of computing depreciation over the shorter of the estimated useful lives of the respective assets or the life of the lease term, excluding any lease renewals, unless the lease renewals are reasonably assured.

# **Community Health Network, Inc. and Affiliates**

## **Notes to Consolidated Financial Statements (in 000's)**

### **December 31, 2008 and 2007**

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Costs of maintenance and repairs are charged to expense when incurred; costs of renewals and betterments are capitalized. Upon sale or retirement of property, plant and equipment, the cost and related accumulated depreciation are eliminated from the respective accounts, and the resulting gain or loss is included in the consolidated statements of operations and changes in net assets.

Long-lived assets are evaluated for possible impairment whenever circumstances indicate that the carrying amount of the asset, or related group of assets, may not be recoverable from future estimated cash flows. Fair value estimates are derived from independent appraisals, established market values of comparable assets or internal calculations of future estimated cash flows.

#### **Investments in Unconsolidated Affiliates**

Investments in affiliates not controlled by the Network are reported under the equity method of accounting. Under the equity method, the investments are initially recorded at cost, increased or decreased by the investor's share of the profits or losses of the investee and reduced by cash distributions received. Distributions received from investees that represent a return on investment are classified as operating cash flows on the consolidated statement of cash flows. Those distributions that represent a return of investment are classified as investing cash flows.

#### **Intangible Assets**

Bond discounts and other costs associated with the issuance of long-term debt, principally underwriters' fees, are carried at cost, net of accumulated amortization. These amounts are amortized to interest expense using the effective interest method over the life of the bonds.

#### **Self-Insured Risk**

A substantial portion of the Network's professional and general liability risks are insured through a self-insured retention program written by our consolidated wholly-owned offshore captive insurance subsidiary, the Captive, as described above.

Reserves for professional and general liability risks, including incurred but not reported claims, were \$12,357 and \$12,307 at December 31, 2008 and 2007, respectively. These amounts are recorded and included in the Captive's incurred but not reported liabilities in the accompanying consolidating balance sheets.

Provisions for the self-insured risks are based upon actuarially determined estimates. Loss and loss expense reserves represent the estimated ultimate net cost of all reported and unreported losses incurred through the respective consolidated balance sheet dates. The reserves for unpaid losses and loss expenses are estimated using individual case-basis valuations and actuarial analyses. Those estimates are subject to the effects of trends in loss severity and frequency. The estimates are continually reviewed and adjustments are recorded as experience develops or new information becomes known. The changes to the estimated reserve amounts are included in current operating results.

# **Community Health Network, Inc. and Affiliates**

## **Notes to Consolidated Financial Statements (in 000's)**

### **December 31, 2008 and 2007**

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The Network is self-insured for medical risks through ProHealth. Reserves for medical claims liabilities and related incurred but not reported claims were \$13,911 and \$22,837 at December 31, 2008 and 2007, respectively. These amounts are recorded and included in ProHealth's incurred but not reported liabilities in the accompanying consolidating balance sheets. Incurred but not reported claims reserves represent estimates for claims that are incurred but not reported. These estimates are determined using individual case-basis data and are continually reviewed and adjusted as new experienced information becomes known. The changes in estimated reserve amounts are included in current operating results.

Although considerable variability is inherent in reserve estimates, management believes the reserves for losses and loss expenses are adequate; however, there can be no assurance that the ultimate liability will not exceed management's estimates.

#### **Temporarily and Permanently Restricted Net Assets**

Temporarily restricted net assets are those whose use by the Network has been limited by donors to a specific time period or purpose. Permanently restricted net assets have been restricted by donors to be maintained by the Network in perpetuity.

#### **Net Patient Service Revenue**

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors and others for services rendered. The Network has agreements with third-party payors that provide for payments to the Network at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, cost reimbursement, discounted charges, and per diem payments. Excluding CHA, the Network offers a 30% discount to uninsured patients. This discount is recorded in other allowances/adjustments, which are netted against net patient service revenue. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

#### **Charity Care**

The Network maintains records to identify and monitor the level of charity care it provides. The Network provides charity care to patients whose income level is below 200% of the Federal Poverty Level. Charity care includes the amount of charges forgone for services and supplies furnished under its charity care policy and was \$53,462 and \$23,811 for the years ended December 31, 2008 and 2007, respectively.

#### **Donor-restricted Gifts**

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received. The gifts are reported as either temporarily or permanently restricted contributions if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of operations as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reflected as unrestricted contributions in the accompanying consolidated financial statements.

# Community Health Network, Inc. and Affiliates

## Notes to Consolidated Financial Statements (in 000's)

### December 31, 2008 and 2007

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#### **Tax Status**

Community, CHS, CHA, CHHS and CPI are exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code (the "Code"), and the Foundation is exempt from federal income taxes under Section 501a(c)(3) of the Code. VEI is a for-profit taxable entity and is subject to federal and state income taxes. NCSC, SCSC and MSI are generally not subject to federal or state income taxes as income earned flows through to its members. ProHealth is a taxable membership organization under the provisions of Section 11(a) and 7701(a)(3) of the Code and is subject to federal and state income taxes. IHH, a limited liability company, is generally not responsible for income taxes. Effective January 1, 2009, IHH became a non-profit limited liability company and is exempt from federal income taxes under 501(c)(3) of the Code.

#### **Fair Value of Financial Instruments/Measurements**

The carrying amounts of cash and cash equivalents, accounts receivable, accounts payable, and other current liabilities approximate fair value because of the relatively short maturities of these financial instruments. The fair value of long-term debt was determined using discounted future cash flows, with a discount rate equal to interest rates for similar types of borrowing arrangements.

The fair value of the Network's long-term debt instruments and related interest approximates \$324,376 and \$387,116 as compared to carrying values of \$373,155 and \$388,665 million as of December 31, 2008 and 2007, respectively.

Effective January 1, 2008, the Network adopted SFAS No. 157. SFAS No. 157 establishes a framework for measuring fair value and expands disclosures regarding fair value measurements. SFAS No. 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. SFAS No. 157 also establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. SFAS No. 157 establishes a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

- Level 1- Observable inputs such as quoted prices in active markets;
- Level 2- Inputs, other than the quoted prices in active markets, that are observable either directly or indirectly; and
- Level 3- Unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

Assets and liabilities measured at fair value are based on one or more of three valuation techniques noted in SFAS No. 157. The three valuation techniques are as follows:

- Market approach- Prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities;
- Cost approach- Amount that would be required to replace the service capacity of an asset (i.e. replacement cost); and
- Income approach- Techniques to convert future amounts to a single present amount based on market expectations (including present value techniques, option-pricing models and lattice models.)

The Network's adoption of SFAS No. 157 also included the adoption of provisions related to the measurement of non-financial assets and liabilities, which did not have material impact on the Network's financial statements.

# Community Health Network, Inc. and Affiliates

## Notes to Consolidated Financial Statements (in 000's)

### December 31, 2008 and 2007

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#### **New Accounting Pronouncements**

In September 2006, the FASB issued SFAS No. 158, "*Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans- an amendment of FASB Statements No. 87, 88, 106 and 132 (R)*". SFAS No. 158 requires an employer to recognize the overfunded or underfunded status of defined benefit pension and postretirement plans as an asset or liability in its consolidated statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income of a business entity or changes in unrestricted net assets for a not-for-profit organization. FASB No. 158 also requires an employer to measure the funded status of a plan as of the date of its year-end statement of financial position. Additionally, FASB No. 158 requires disclosure in the notes to the financial statements of additional information about certain effects on net periodic benefit cost for the next fiscal year that arise from delayed recognition of the gains or losses, prior service costs or credits, and transition assets or obligations. The disclosure provisions of SFAS No. 158 were effective for the Network for the year ended December 31, 2007. Effective January 1, 2008, the Network adopted the measurement date provision. Accordingly, the Network's pension benefits are measured as of December 31, 2008.

In February 2007, the FASB issued SFAS No. 159, "*The Fair Value Option for Financial Assets and Financial Liabilities-Including an amendment of FASB Statement No. 115*." SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS No. 159 is effective for fiscal years that begin after November 15, 2007. The Network adopted SFAS No. 159 effective January 1, 2008. The Network did not elect any fair value options under the provisions of SFAS No. 159.

## **2. Net Patient Service Revenue and Concentrations of Credit Risk**

The Network has agreements with third-party payors that provide for payments to the Network at amounts different from its established rates. Payment arrangements with major third-party payors include:

- Medicare—Inpatient acute care services, outpatient services and home health services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to patient classification systems that are based on clinical, diagnostic, and other factors. The Network is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the Network and audits thereof by the Medicare fiscal intermediary. The Network's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization under contract with the Network. The Network's Medicare cost reports have been audited by the Medicare fiscal intermediary through December 31, 2006. Laws and regulations governing the Medicare program are complex and subject to interpretation. As a result, there is at least a possibility that recorded estimates could change by a material amount in the near term. Adjustments to revenue related to prior period cost reports increased/ (decreased) net patient service revenue by approximately \$112 and (\$1,674) for the years ended December 31, 2008 and 2007, respectively. Medicare patients account for approximately 41.7% and 38.7% of gross patient charges for years ended December 31, 2008 and 2007, respectively.

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- **Medicaid**—Inpatient services rendered to Medicaid program beneficiaries are reimbursed based on prospectively determined rates per discharge and outpatient services are reimbursed based on a fee for service basis, based on predetermined fee schedules. Medicaid patients account for approximately 9.6% and 9.2% of gross patient charges for years ended December 31, 2008 and 2007, respectively.

The Network has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to the Network under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined per diem rates.

Provisions have been made in the consolidated financial statements for estimated contractual adjustments, representing the difference between the established charges for services and estimated total payments to be received from third-party payors. Estimated settlements are accrued in the period the related services are rendered and adjusted in future periods as settlements are determined.

Net patient service revenue, as reflected in the accompanying consolidated statements of operations and changes in net assets, consist of the following for the years ended December 31, 2008 and 2007:

	<b>2008</b>	<b>2007</b>
Gross patient service revenue	\$ 2,420,007	\$ 2,161,101
Deductions from gross patient service revenue		
Medicare/Medicaid contractual adjustments	810,760	691,663
Other adjustments	475,300	439,606
Charity discounts for patient care	53,462	23,811
Net patient service revenue	<u>\$ 1,080,485</u>	<u>\$ 1,006,021</u>

The Network grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. A significant portion of the Network's revenue is concentrated by payor mix. The concentration of gross receivables by payor class for both patients and third-party payors at December 31, 2008 and 2007 is as follows:

	<b>2008</b>	<b>2007</b>
Medicare	25 %	23 %
Medicaid	12	12
Managed care and commercial insurance	50	53
Patients	13	12
	<u>100 %</u>	<u>100 %</u>

Adjustments to the allowance for doubtful accounts are made after the Network has analyzed historical cash collections and considered the impact of any known material events. Uncollectible accounts are written-off against the allowance for doubtful accounts after exhausting collection efforts. Any subsequent recoveries are recorded against the provision for bad debts.

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**3. Assets Limited as to Use**

**Funds Held by Trustee**

The following is a summary of assets limited as to use, which are held by trustees, at December 31, 2008 and 2007:

	<b>2008</b>	<b>2007</b>
Cash and cash equivalents	\$ 21,784	\$ 23,078
Less amount classified as current assets to meet current obligations	<u>7,899</u>	<u>9,439</u>
Noncurrent asset	<u>\$ 13,885</u>	<u>\$ 13,639</u>

The Hospital Revenue Bond Agreements (Note 7) require that the initial bond proceeds be held by a bank trustee until such funds are expended for eligible assets. Certain other funds are also held by the bank trustee as additional security for the bondholders and the periodic deposits of principal and interest requirements. These amounts, including interest earned from temporary investments, are segregated in accounts maintained by a bank trustee. Use of the funds is restricted to debt service requirements. All funds are cash and cash equivalents, which approximate fair value and are designated as Level 1 in accordance with SFAS No. 157.

**Board-designated Funds**

As discussed in Note 1, the Network reclassified its Board-designated funds and reinsurance trust assets as trading securities effective January 1, 2007. As a result, those investments are marked to market each month.

The following is a summary of the investments limited as to use, which are board-designated funds, at December 31, 2008 and 2007:

	<b>2008 Cost</b>	<b>2008 Market</b>
Cash and cash equivalents	\$ 1,169	\$ 1,169
U.S. Treasury bonds	26,499	23,340
Corporate bonds	54,954	43,659
Equity securities	229,649	153,658
Hedge Fund of Funds	10,470	8,832
REITS/Other	<u>21,203</u>	<u>12,744</u>
	<u>\$ 343,944</u>	<u>\$ 243,402</u>
	<b>2007 Cost</b>	<b>2007 Market</b>
Cash and cash equivalents	\$ 4,343	\$ 4,343
U.S. Treasury bonds	115,843	118,630
Corporate bonds	32,492	32,166
Equity securities	<u>170,487</u>	<u>197,937</u>
	<u>\$ 323,165</u>	<u>\$ 353,076</u>



**Community Health Network, Inc. and Affiliates**  
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Description	Fair Value Measurements at Reporting Date Using			
	2008	Level 1	Level 2	Level 3
Fixed Income	\$ 62,085	\$ 62,085	\$ -	\$ -
Equity—Domestic Large Cap	59,238	39,136	20,102	-
Equity—Domestic Small Cap	21,434	1,951	19,483	-
Equity—International	71,246	71,246	-	-
Hedge Fund of Funds	8,832	-	-	8,832
REITS/Other	20,567	20,567	-	-
Total	<u>\$ 243,402</u>	<u>\$ 194,985</u>	<u>\$ 39,585</u>	<u>\$ 8,832</u>

	Rollforward of Level 3 Investments
Balances as of January 1, 2008	\$ -
Purchases	10,470
Investment loss-realized/unrealized	<u>(1,638)</u>
Balance as of December 31, 2008	<u>\$ 8,832</u>

The fair values of the board designated funds are provided the Network's investment manager and are determined as follows:

- The funds designated as level 1 inputs represent equity securities and investable mutual fund shares that are traded on major stock exchanges. Thus, the fair value is determined based on quoted prices in an active market.
- The funds designated as level 2 inputs represent separately publicly traded securities held in separately managed institutional investment accounts managed by a professional money manager. The individual securities are traded on major stock exchanges but the blended portfolio is not investable as a unit. The fair value is determined by reviewing the underlying valuation of each individual publically traded stock that comprises the holdings of the fund.
- The funds designated as level 3 inputs represents hedge funds. The fair values of the hedge funds are obtained by individual hedge fund managers and custodians. The hedge fund of fund manager employs best practices controls and due diligence to ensure the valuations are reflective of fair value. Additionally, the individual hedge funds are audited annually and an audit reports issued.

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Investment income for 2008 and 2007 related to Board-designated funds consists of the following:

	2008	2007
Interest and dividend income	\$ 15,722	\$ 13,359
Unrealized gain (loss)	(131,028)	-
Net realized gains on sales of investment securities	1,350	12,433
Total investment (loss) income	<u>\$ (113,956)</u>	<u>\$ 25,792</u>

**Reinsurance Trust Assets**

The assets in the trust includes cash and cash equivalents maintained in a domestic trust account. These assets are restricted and may not be withdrawn or used without the consent of the trust administrator.

The following is a summary of the investments limited as to use, which are reinsurance trust assets, at December 31, 2008 and 2007:

	2008 Cost	2008 Market	2007 Cost	2007 Market
U.S. Treasury bonds	\$ 999	\$ 1,037	\$ 3,495	\$ 3,502
Corporate bonds	3,442	3,380	1,496	1,522
Federal Government Agency mortgage backed securities	4,406	4,704	4,683	4,762
Cash and cash equivalents held in trust	2,967	2,967	2,148	2,148
	<u>\$ 11,814</u>	<u>\$ 12,088</u>	<u>\$ 11,822</u>	<u>\$ 11,934</u>

Description	Fair Value Measurements at Reporting			
	2008	Level 1	Level 2	Level 3
Federal Government Agency and mortgage backed securities	\$ 4,704	\$ -	\$ 4,704	\$ -
Corporate bonds	3,380	-	3,380	-
U.S. Treasury bonds	1,037	-	1,037	-
Money Market Funds	2,967	-	2,967	-
Total	<u>\$ 12,088</u>	<u>\$ -</u>	<u>\$ 12,088</u>	<u>\$ -</u>

The fair values of the investments limited as to use are provided the Captive's investment manager and are determined as follows:

- The fair value of fixed income securities including corporate debt are generally determined on the basis of valuations provided by a pricing service which will typically utilize industry accepted valuation models and observable market inputs to determine valuation; some valuations or model inputs provided/used by the pricing service may be, or be based upon, broker quotes.
- The fair value of investments in money market funds is determined based on the net asset value per share provided by the administrators of the funds.

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Investment income for 2008 and 2007 related to reinsurance trust assets consists of the following:

	<b>2008</b>	<b>2007</b>
Interest income	\$ 484	\$ 510
Net realized/unrealized gains on investment securities	170	98
Total investment income	<u>\$ 654</u>	<u>\$ 608</u>

**4. Property, Plant and Equipment**

Property, plant and equipment and accumulated depreciation consist of the following at December 31, 2008 and 2007:

	<b>Estimated Useful Lives</b>	<b>2008</b>	<b>2007</b>
Land and land improvements	0-20 years	\$ 26,146	\$ 24,864
Buildings and improvements	10-40 years	630,060	604,225
Equipment	3-20 years	482,345	458,628
Construction in progress		35,857	11,116
		<u>1,174,408</u>	<u>1,098,833</u>
Less: accumulated depreciation		<u>587,541</u>	<u>553,387</u>
		<u>\$ 586,867</u>	<u>\$ 545,446</u>

Depreciation expense was \$57,109 and \$55,222 for 2008 and 2007, respectively. The increase in construction in progress and the increase in buildings and improvements and equipment is primarily attributable to the South expansion and ambulatory project scheduled to open in mid 2010.

**5. Investments in Unconsolidated Affiliates**

The Network has equity investments in various \$57,109 surgery centers, Mid America Clinical Laboratory ("MACL") and other entities.

**Community Health Network, Inc. and Affiliates**  
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The following is a summary of the Network's investments in unconsolidated affiliates for the years ended December 31, 2008 and 2007:

	<b>Surgery Centers</b>	<b>MACL</b>	<b>Other</b>	<b>Total</b>
<b>Balance, December 31, 2006</b>	\$ 16,732	\$ 3,990	\$ 2,498	\$ 23,220
Capital contributions	2,731	-	98	2,829
Distributions	(10,695)	(1,936)	(2,188)	(14,819)
Equity in net income	10,733	2,021	1,940	14,694
<b>Balance, December 31, 2007</b>	<b>\$ 19,501</b>	<b>\$ 4,075</b>	<b>\$ 2,348</b>	<b>\$ 25,924</b>
Capital contributions	501	-	846	1,347
Distributions	(12,499)	(2,061)	(2,932)	(17,492)
Equity in net income	11,476	1,965	1,661	15,102
<b>Balance, December 31, 2008</b>	<b>\$ 18,979</b>	<b>\$ 3,979</b>	<b>\$ 1,923</b>	<b>\$ 24,881</b>

Summarized and aggregated financial statement information for the surgery centers, MACL and the other unconsolidated affiliates is as follows (in thousands):

	<b>Surgery Centers</b>	<b>MACL</b>	<b>Other</b>	<b>Total</b>
Total assets	\$ 67,860	\$ 33,086	\$ 27,085	\$ 128,031
Total liabilities	27,435	14,997	14,307	56,739
Net assets	40,425	18,089	12,827	71,341
Revenues	117,496	70,865	56,087	244,448
Operating income	27,741	8,787	10,356	46,884
Net income	27,606	8,934	9,756	46,296
Network's equity in net income of unconsolidated affiliates	10,898	1,965	2,239	15,102

**6. Transactions with Unconsolidated Affiliates and Related Parties**

The Network provides services to and makes purchases on behalf of various unconsolidated affiliated entities. The range of ownership in unconsolidated affiliates is 2 to 70 percent. Amounts due to unconsolidated affiliates and related parties consist of the following at December 31, 2008 and 2007:

	<b>2008</b>	<b>2007</b>
Notes payable—North Campus Office Associates (NCOA)	\$ 884	\$ 693
Notes receivable—Indianapolis Internal Medicine Corp. (IIMC)	(118)	(327)
Receivables from physicians	(169)	(28)
Due to Spec Prime/MedPrime	856	3,350
Due to Indiana Surgery Centers	12,734	12,711
Other payables	521	313
Due to unconsolidated affiliates and related parties, net	<b>\$ 14,708</b>	<b>\$ 16,712</b>

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**7. Debt**

**Short-term Borrowings**

Short-term borrowings represent outstanding borrowings under bank lines of credit. At December 31, 2008 and 2007, the following amounts were outstanding:

	<b>Maximum Borrowings</b>	<b>Outstanding Balance</b>	
		<b>2008</b>	<b>2007</b>
CHI	\$ 70,000	\$ 14,300	\$ -
VEI	13,500	13,500	13,500
CHA	1,000	-	-
		<u>\$ 27,800</u>	<u>\$ 13,500</u>

The bank lines of credit are due on demand. Interest is payable monthly on VEI's line of credit. VEI's short-term debt is collateralized by mortgages on six properties and is also guaranteed by CHI. Interest is at a floating rate, and the weighted-average effective rate on short-term borrowings was 4.28 percent and 6.20 percent for the years ended December 31, 2008 and 2007, respectively. CHI has two separate lines of credit with two different banks. As of December 31, 2008, CHI has drawn down on the \$50.0 million line of credit. Interest is payable quarterly at a variable rate. The variable rate is determined by either the prime rate less 200 basis points or LIBOR plus 30 basis points at CHI's election at the time of each draw. The weighted-average effective rate on this line of credit was 2.46 percent for the year ended December 31, 2008.

**Long-term debt**

Long-term debt at December 31, 2008 and 2007 is summarized as follows:

	<b>Obligated Entity</b>	<b>2008</b>	<b>2007</b>
Indiana Health Facility Financing Authority, Hospital Revenue Bonds, Series 2005A; interest payable semiannually 4.50% serial bonds due May 1, 2008 to May 1, 2025 5.00% term bonds due May 1, 2035 Unamortized premium	CHI	\$ 71,220 78,970 4,101 <u>154,291</u>	\$ 73,850 78,970 4,257 <u>157,077</u>
Indiana Health Facility Financing Authority, Adjustable Rate Hospital Revenue Bonds, Series 2005B; interest payable monthly (2.38% effective rate at December 31, 2008) due May 1, 2008 to May 1, 2035	CHI	18,300	18,700
Indiana Health Facility Financing Authority, Adjustable Rate Hospital Revenue Bonds, Series 2005C; interest payable monthly (2.75% effective rate at December 31, 2008) due May 1, 2008 to May 1, 2035	CHI	18,400	18,800
Indiana Health Facility Financing Authority, Adjustable Rate Hospital Revenue Bonds, Series 2000A and 2000B; interest payable monthly (1.20% effective rate at December 31, 2008) due July 1, 2002 to July 1, 2028	CHI	38,600	38,800

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	Obligated Entity	2008	2007
Indiana Health Facility Financing Authority, Adjustable Rate Hospital Revenue Bonds, Series 1997A and 1997B; interest payable monthly (1.15% effective rate at December 31, 2008) due July 1, 2020 to July 1, 2027	CHI	\$ 30,000	\$ 30,000
Indiana Health Facility Financing Authority, Hospital Revenue Refunding and Improvement Bonds, Series 1995; interest payable semiannually	CHI	6,610	7,955
5.6% term bonds due May 15, 2014		37,368	37,368
5.7% term bonds due May 15, 2022		(336)	(361)
Unamortized discount		<u>43,642</u>	<u>44,962</u>
Indiana Health Facility Financing Authority, Hospital Revenue Bonds, Series 1993; interest payable semiannually	CHA	18,670	19,455
6.00% term bonds, due January 1, 2023		<u>18,670</u>	<u>19,455</u>
Indiana Health Facility Financing Authority, Hospital Revenue Refunding and Improvement Bonds, Series 1992; interest payable semiannually:	CHI	24,020	27,665
6.40% term bonds due May 1, 2012 with mandatory redemption from May 1, 2006 to 2012		(33)	(41)
Unamortized discount		<u>23,987</u>	<u>27,624</u>
Indiana Health Facility Financing Authority, Hospital Revenue Bonds, Series 1992A; interest payable semiannually	CHI	14,370	15,545
6.85% term bonds due July 1, 2022		<u>14,370</u>	<u>15,545</u>
Hospital Authority of Madison County, Inc., Hospital Revenue Bonds, Series 1988A; interest payable semiannually	CHA	4,660	5,250
8.00% term bonds, due January 1, 2014		<u>4,660</u>	<u>5,250</u>
Other long-term debt		<u>8,235</u>	<u>12,452</u>
		373,155	388,665
Less: current portion of long-term debt		<u>13,658</u>	<u>15,666</u>
Long-term debt, net of current portion		<u>\$ 359,497</u>	<u>\$ 372,999</u>

# **Community Health Network, Inc. and Affiliates**

## **Notes to Consolidated Financial Statements (in 000's)**

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#### ***Series 2005A, 2005B and 2000C***

On May 1, 2005, the Indiana Health Financing Authority, (the "Authority") issued Hospital Revenue Bonds, Series 2005A and Adjustable Rate Hospital Revenue Bonds, Series 2005B and 2005C, in the aggregate amount of \$190,320 for the purpose of making a loan to the Network. The proceeds of this loan from the Authority are available to finance, refinance or reimburse the costs of constructing, acquiring, renovating or equipping certain health facility property used by CHI. As credit support for the 2005B and 2005C bonds, the Network has two outstanding letters of credit with banks for a maximum aggregate principal draw amount of \$36,700 plus accrued interest as of December 31, 2008. The letters of credit expire May 4, 2010. The Series 2005A bonds maturing on or after May 1, 2016 are subject to redemption prior to their respective stated maturities, by the Authority, upon the direction of CHI at a redemption price equal to 100% of the principal amount plus accrued interest thereon to the date fixed for redemption. The Series 2005B and Series 2005C bonds are subject to redemption prior to their stated maturity at the option of CHI on a thirty day notice in whole or in part, at a redemption price equal to 100% of the principal amount plus interest at the date of redemption.

#### ***Series 2000A and 2000B***

On November 1, 2000, the Authority issued Adjustable Rate Hospital Revenue Bonds, Series 2000A and 2000B, in the aggregate amount of \$40,000 for the purpose of making a loan to the Network. The proceeds of this loan from the Authority were available to finance, refinance or reimburse the costs of constructing, acquiring, renovating or equipping certain health facility property used by CHI. As of December 31, 2008, the outstanding letter of credit with the bank associated with this debt is the principal amount of \$38,600 plus accrued interest. The letter of credit expires May 29, 2010. The Series 2000A and 2000B bonds are subject to redemption at the option of CHI on a thirty day notice at a redemption price equal to 100% of the principal amount plus interest at the date of redemption.

#### ***Series 1997A and 1997B***

On August 1, 1997, the Authority issued its Adjustable Rate Hospital Revenue Bonds, Series 1997A and Series 1997B in the aggregate amount of \$30,000 for the purpose of making a loan to the Network. The proceeds of this loan from the Authority were used for the financing of certain health facility property. As of December 31, 2008, the outstanding letter of credit with the bank associated with this debt is the principal amount of \$30,000 plus accrued interest. The letter of credit expires May 1, 2010. The Series 1997A and 1997B bonds are subject to redemption at the option of CHI on a thirty day notice at a redemption price equal to 100% of the principal amount plus interest at the date of redemption.

#### ***Series 1995***

On November 15, 1995, the Authority issued \$75,050 of Hospital Revenue Refunding and Improvement Bonds (Series 1995 Bonds). Concurrent with the issuance of the bonds, the Network and the Authority entered into a loan agreement (the "Agreement") in which the Network agreed to make loan payments to meet the terms of the hospital revenue bonds. The Agreement restricts the amount of indebtedness that the Network may incur and provides to the Authority an interest in the Network's gross revenues sufficient to meet principal and interest obligations. The Series 1995 Bonds are callable in accordance with the provisions of the Agreement commencing May 15, 2006 at prepayment prices ranging from 102 percent to 100 percent of the principal outstanding.

In May 2007, CHI made a tender offer to existing 1995 Series Bondholders for a 102 percent tender price. At the end of the offer, CHI called and redeemed the remaining \$2,067 in bonds outstanding at a price of 101 percent. The premium and related transaction fees total \$1,169 and are included in interest and financing costs.

# **Community Health Network, Inc. and Affiliates**

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A bank purchased the tendered bonds for par value. Simultaneously, CHI and the bank entered into an interest rate swap agreement (the "1995 swap"), the purpose of which was to synthetically convert the tendered bonds from a fixed rate to a variable rate based on the Securities Industry and Financial Markets Association Municipal Swap Index plus .30 percent. The variable rate at December 31, 2008 was 1.55%. The swap is a fair value hedge recognized on the consolidated balance sheet at its fair value with changes as a result of ineffectiveness since inception being recorded in interest expense. The swap is in place throughout the term of the outstanding bonds, but may be terminated by CHI or the bank with 30 and 180 days notice, respectively. Neither the terms nor conditions of the original bonds were altered in any way. The fair value and net gain associated with the 1995 swap were immaterial.

#### ***Series 1993, 1992, 1992A, and 1988A***

With respect to the Series 1993, 1992, 1992A, and 1988A Hospital Revenue Bonds, there are loan agreements between the Network and the conduit issuing authorities with similar terms as described for the Series 1995 Hospital Revenue Bonds except the bonds are callable as follows: January 1, 2007 for Series 1993; May 1, 2002 for Series 1992; July 1, 2002 for Series 1992A; and January 1, 2001 for Series 1988A.

In February 2004, CHI made a tender offer to existing 1992 and 1992A Series Bondholders for a 102 percent tender price. At the end of the offer, CHI called and redeemed the remaining \$7,250 in bonds outstanding at a price of 101 percent. The premium and related transaction fees total \$1,134 and are included in interest and financing costs.

A bank purchased the tendered bonds for par value. Simultaneously, CHI and the bank entered into an interest rate swap agreement (the swap), the purpose of which was to synthetically convert the tendered bonds from a fixed rate to a variable rate based on the Bond Market Association Municipal Swap Index plus .40 percent. The variable rate at December 31, 2008 was 1.65 percent. The swap is a fair value hedge recognized on the consolidated balance sheet at its fair value with changes as a result of ineffectiveness since inception being recorded in interest expense. The swap is in place throughout the term of the outstanding bonds, but may be terminated by CHI or the bank with 30 and 180 days notice, respectively. Neither the terms nor conditions of the original bonds were altered in any way. The fair value and net gain associated with the swap were immaterial.

In general, the various Network debt agreements restrict the amount of indebtedness that the Network may incur, the sale, lease or other disposition of operating assets, and the acceptable investments of the trust funds. In addition, these agreements require a debt service ratio at the end of any fiscal year of at least 1.10. Effective December 31, 2008, the Network's debt agreements were amended to exclude unrealized investment gains/losses from the definition of net income available for debt service. The Network was in compliance with all debt covenants at December 31, 2008



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Scheduled principal repayments on long-term debt are as follows:

2009	\$ 13,658
2010	15,293
2011	15,272
2012	14,913
2013	14,015
Thereafter	<u>296,272</u>
	369,423
Plus: unamortized premium, net	<u>3,732</u>
	<u>\$ 373,155</u>

For 2008 and 2007, interest cost incurred and capitalized in connection with the construction of capital assets aggregated \$307 and \$0, respectively.

**8. Employee Benefit Plans**

**Defined Benefit and Other Postretirement Benefit Plans**

The Network has defined benefit retirement plans covering substantially all employees of CHI, CHA, CHHS, IHH, and CBI. The Network's funding policy is to contribute the equivalent of the minimum funding required by the Employee Retirement Income Security Act of 1974, as amended. The benefits for these plans are based primarily on years of service and the 60-consecutive-month period of employment producing the highest total income. For the year ended December 31, 2007, the measurement date is September 30, except for the Replacement Plan which is January 1. Effective January 1, 2008, the Network adopted the measurement provisions of SFAS No. 158 which changed the measurement date to December 31. As a result, the Network experienced 15 months of defined benefit pension expense during 2008. As permitted by SFAS No. 158, the Network recorded three months of the defined benefit pension expense or \$3,399 in unrestricted net assets.

The Community Health Network Retirement Plan is a defined benefit plan. The provisions of this plan relate to all employees of CHI, CHA, CHHS, IHH, CPI and CBI. These employees are eligible to participate in the plan after one year of eligible service as defined by the plan document. Participants are 100% vested after five years of service. Effective May 27, 2006, CHA froze the accrual of benefits and participation in the Community Health Network Retirement Plan and established its own 403(b) plan. CHI made no contributions to the plan during 2007 and 2006.

The Replacement plan is both a defined benefit and a defined contribution plan. The fair value of the plan assets was \$14,003 and \$13,886 at December 31, 2008 and 2007, respectively. The defined benefit provisions of the plan apply to all employees of the Network hired prior to January 1, 1984. The plan was originally established on that date to provide such employees those benefits otherwise available under the Federal Insurance Contributions Act during the period January 1, 1981 to December 31, 1983 when the Network withdrew coverage of its employees under the Act. Pursuant to the Social Security Amendment Act of 1983, the Network reentered the Social Security system on January 1, 1984. As a result funding of the plan was terminated during 1985. The actuarial present value of accumulated plan benefits was \$6,391 and \$6,596 for 2008 and 2007, respectively. The Network also has other postretirement benefit plans covering substantially all of its employees, providing retirees' health insurance benefits for the same premium as the Network pays for active employees. The Network funds the plan on a cash basis.

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As described in Note 1, the Network adopted the disclosure provisions of SFAS No. 158 as of December 31, 2007. As a result, the Network recognized the funded status of its defined benefit and postretirement benefit plans in its consolidated balance sheet as of December 31, 2007. The impact of the adoption of SFAS No. 158 on the Network's consolidated balance sheet is as follows:

	<b>Prior to Adoption of SFAS No. 158</b>	<b>SFAS No. 158 Adjustments</b>	<b>Post Adoption of SFAS No. 158</b>
Prepaid pension assets	\$ -	\$ 20,771	\$ 20,771
Prepaid postretirement assets	-	1,482	1,482
Accrued postretirement pension cost	(3,269)	-	(3,269)
Accrued pension	(41,207)	-	(41,207)
Unrestricted net assets	-	(22,253)	(22,253)

**Effect on Operations**

The components of net pension expense for defined benefit retirement plans and the postretirement benefit plan for the year ended December 31 were as follows:

	<b>Pension Benefits</b>		<b>Postretirement Benefits</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Service cost	\$ 24,340	\$ 18,445	\$ 310	\$ 269
Interest cost	29,587	21,730	133	77
Expected return on plan assets	90,076	(49,674)	-	-
Amortization of prior service cost, net	(127,342)	21,730	(98)	(92)
Net pension expense	\$ 16,661	\$ 12,231	\$ 345	\$ 254

**Obligations and Funded Status**

The change in benefit obligations, plan assets and funded status for the Network's defined benefit retirement plans are as follows:

	<b>Pension Benefits</b>		<b>Postretirement Benefits</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
<b>Change in benefit obligation</b>				
Benefit obligation, beginning of period	\$ 397,619	\$ 382,441	\$ 3,269	\$ 3,003
Service cost	24,340	18,445	345	254
Interest cost	29,587	21,730	-	-
Actuarial gain	(2,010)	(16,639)	-	-
Benefits paid—estimated	(11,721)	(8,358)	(16)	12
Benefit obligation, end of period	\$ 437,815	\$ 397,619	\$ 3,598	\$ 3,269

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	<b>Pension Benefits</b>	
	<b>2008</b>	<b>2007</b>
<b>Change in plan assets</b>		
Fair value of plan assets, beginning of year	\$ 377,183	\$ 336,876
Actual return on plan assets	(90,076)	49,674
Benefit paid—actual	(13,803)	(9,367)
Fair value of plan assets, end of year	<u>\$ 273,304</u>	<u>\$ 377,183</u>

	<b>Pension Benefits</b>		<b>Postretirement Benefits</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
<b>Reconciliation of Funded status</b>				
Accrued pension cost	\$ (57,868)	\$ (41,207)	\$ (3,598)	\$ (3,269)
Prepaid pension asset (liability)	(106,643)	20,771	1,555	1,482
Funded status	(164,511)	(20,436)	(2,043)	(1,787)
Unrecognized net actuarial loss (gain)	118,725	(6,994)	(1,742)	(1,691)
Unrecognized prior service cost	(12,082)	(13,777)	187	209
Accrued pension cost	<u>\$ (57,868)</u>	<u>\$ (41,207)</u>	<u>\$ (3,598)</u>	<u>\$ (3,269)</u>

**Accumulated Benefit Obligation**

Selected information from the plans with accumulated benefit obligation in excess of plan assets at December 31, were as follows:

	<b>Pension Benefits</b>		<b>Postretirement Benefits</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Projected benefit obligation	\$ 437,815	\$ 397,619	\$ 3,598	\$ 3,269
Accumulated benefit obligation	397,909	346,612	2,042	1,787
Fair value of plan assets	273,304	377,183	-	-

**Actuarial Assumptions**

Weighted average assumptions used to determine benefit obligations as of December 31:

	<b>Pension Benefits</b>		<b>Postretirement Benefits</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Discount rate	5.80%	6.00%	5.80%	6.00%
Rate of compensation increase	3.50%	4.50%	0.00%	0.00%

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Weighted average assumptions used to determine net periodic benefit cost for the years ended December 31:

	<b>Pension Benefits</b>		<b>Postretirement Benefits</b>	
	<b>2008</b>	<b>2007</b>	<b>2008</b>	<b>2007</b>
Discount rate	6.00%	5.75%	6.00%	5.75%
Rate of compensation increase	4.50%	4.50%	0.00%	0.00%
Expected long-term rate of return on plan assets	7.60%	8.00%	0.00%	0.00%

The expected long term rate of return assumes targeted allocations are maintained and returns fall within standard deviation derived from simulation of ten year range of returns on each plan's assets. The rate is reevaluated based on actual returns in the current period, which resulted in the percentage decreasing from 8.0% for 2007 to 7.6% for 2008.

**Assumed Health Care Costs**

In establishing the net periodic postretirement benefit expense, a 9 percent annual rate of increase in per capital cost of covered health benefits was assumed for 2008 and 2007. The rate was assumed to decrease gradually to 6 percent over an 18-year period. Changing the assumed health care cost trend rates by one percentage point in each year would cause an incremental increase in the accumulated postretirement benefit obligation of less than \$246 and \$217 in 2008 and 2007, respectively.

**Plan Assets**

The weighted-average allocation of our domestic defined benefit plans at December 31, 2008 and 2007, by asset category are as follows:

	<b>Retirement Plan</b>			<b>Replacement Plan</b>		
	<b>2008</b>		<b>2007</b>	<b>2008</b>		<b>2007</b>
	<b>Target</b>	<b>Actual</b>	<b>Actual</b>	<b>Target</b>	<b>Actual</b>	<b>Actual</b>
	<b>Allocation</b>	<b>Allocation</b>	<b>Allocation</b>	<b>Allocation</b>	<b>Allocation</b>	<b>Allocation</b>
Equity securities	15-75%	41%	68%	61%	63%	86%
Fixed income securities	20-70%	48%	32%	22%	25%	14%
Real estate	0-5%	2%	0%	2%	2%	
Other	0-35%	9%	0%	15%	10%	0%
Total	100%	100%	100%	100%	100%	100%

The plans are administered under a single investment policy statement, which outlines objectives and guidelines for supervising investment strategy and evaluating the investment performance for all investment assets of CHI. The policy seeks to preserve principal, emphasizing long-term growth without undue exposure to risk. Investment performance return targets are based on consumer price, corporate bond and stock indexes as well as volatility standards (beta) and positive risk-adjusted performance (alpha). The plan fiduciaries oversee the investment allocation process, which includes selecting investment managers, setting long-term strategic targets and monitoring asset allocations. Target allocation ranges are guidelines, not limitations, and plan fiduciaries may occasionally approve allocations above or below a target range.

**Community Health Network, Inc. and Affiliates**  
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**Cash Flows**

The Network does not expect to make any contributions to any of the defined benefit plans in fiscal 2009.

**Estimated Future Benefit Payments**

Plan benefit payments, which reflect expected future service, are expected to be paid as follows:

	<b>Pension Benefits</b>	<b>Postretirement Benefits</b>
2009	\$ 12,559	18
2010	13,814	39
2011	14,939	64
2012	16,514	87
2013	17,799	115
2014-2018	122,884	1,106

**Other**

Effective January 1, 2004, the Network amended the terms of the defined benefit plan. Under the amended plan, the formula for calculating benefits changed by reducing the percentages applied to a participant's monthly plan compensation. Also, the Community Physicians of Indiana, Inc. participants became ineligible. Retirement benefits earned prior to December 31, 2003 remain unchanged.

The Network also sponsors defined contribution plans covering certain employees. Employer contributions are made to these plans based on a percentage of employee compensation. The cost of these defined contribution plans was approximately \$5,376 million and \$5,168 million for 2008 and 2007, respectively. If authorized by the Network's Board of Directors, each Replacement plan participant may elect to contribute to the plan an amount each pay period, subject to the maximum established by the Board of Directors. Such authorization was not granted during 2008 and 2007.

One of the defined contribution plans relates to VEI's profit sharing 401(k) plan, in which employees are eligible to participate immediately upon hire and after attaining 21 years of age. Participants may contribute from one percent to fifty percent of compensation, as defined. Each year, VEI's Board of Directors may elect to match a portion of participant contributions through a discretionary profit sharing contribution. The expense associated with this plan was approximately \$1,848 and \$1,999 for the years ended December 31, 2008 and 2007, respectively.

IHH has a 401(k) plan, in which employees are eligible to participate immediately upon hire and after attaining 21 years of age. Participants may contribute from one percent to sixty percent of compensation, as defined. IHH matches 50% of participant contributions up to 5% of the participants' compensation. The expense associated with this plan was approximately \$266 and \$244 for the years ended December 31, 2008 and 2007, respectively.

CPI has a defined contribution profit sharing plan in which employees who are designated as CPI physicians and are paid on the compensation model are eligible to participate after the completion of one year of service. This plan is an employer funded plan whereby the funding is charged to the participating physician's practice as an overhead expense. The expense associated with this plan was approximately \$627 and \$514 for the years ended December 31, 2008 and 2007, respectively.

# Community Health Network, Inc. and Affiliates

## Notes to Consolidated Financial Statements (in 000's)

### December 31, 2008 and 2007

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Effective May 28, 2006, CHA established a defined contribution 403(b) plan. Employees are eligible to participate immediately upon employment. Participants may contribute up to 100% of compensation, as defined. CHA matches 100% of participant contributions up to 3% of the participant's compensation. The expense associated with this plan was \$2,635 and \$2,411 for the years ended December 31, 2008 and 2007, respectively.

Effective January 1, 2009, the Network established a 401(k) plan on behalf of CHI. Employees hired after February 9, 2008 are eligible to participate immediately upon employment. Participants may contribute up to 100% of compensation, as defined. The Network matches 100% of participant contributions up to 6% of the participant's compensation.

#### 9. Income Taxes

For 2008 and 2007, federal taxable income originating in the Network's for-profit entities was approximately \$12.4 million and \$11.8 million, respectively. Income tax expense of \$6,805 and \$5,711, respectively, has been provided thereon. The primary difference between income tax expense and taxes computed at the federal statutory rate of 34 percent is state income taxes. Additionally, VEI accrued federal income taxes due to disallowed charitable deductions in prior years' returns.

At December 31, 2008, ProHealth has unused federal income tax operating loss carry forwards of approximately \$15,083, which expire at various dates through 2028. The tax benefits from these net operating losses of \$5,128 have been fully offset by valuation allowances of \$5,128 and \$3,741 at December 31, 2008 and 2007, respectively.

#### 10. Operating Leases

The Network leases certain of its facilities and equipment under noncancelable operating lease agreements. The leases contain various renewal options and clauses for escalation based on increases in interest costs, as defined. Rental expense for these leased facilities and equipment aggregated \$28,026 and \$23,865 for 2008 and 2007, respectively.

Future minimum rental payments for each of the next five years at December 31, 2008 are as follows:

2009	\$ 21,354
2010	19,217
2011	14,614
2012	11,926
2013	8,702
Thereafter	44,876

**Community Health Network, Inc. and Affiliates**  
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**11. Functional Expenses**

The Network provides services to residents within its geographic locations. Expenses related to providing these services are as follows:

	<b>2008</b>	<b>2007</b>
Nursing services	\$ 303,781	\$ 283,990
Other professional services	264,172	239,745
General services	146,709	136,005
Fiscal services	149,728	142,093
Administrative services	98,578	87,514
Employee health and welfare	84,771	75,268
Health service claims expense	377	43,102
Depreciation and amortization	57,570	55,732
Provision for bad debts	54,173	55,335
Interest	15,946	19,714
	<u>\$ 1,175,805</u>	<u>\$ 1,138,498</u>

**12. Temporarily and Permanently Restricted Net Assets**

Temporarily restricted net assets are those whose use by the Network has been limited by donors to a specific time period or purpose. Temporarily restricted net assets as of December 31, 2008 and 2007 are available for the following purposes:

	<b>2008</b>	<b>2007</b>
Medical education	\$ 1,207	\$ 70
Clinical/patient support	620	501
Capital improvements	2,560	4,155
	<u>\$ 4,387</u>	<u>\$ 4,726</u>

Permanently restricted net assets have been restricted by donors to be maintained by the Network in perpetuity. Permanently restricted net assets as of December 31, 2008 and 2007 are as follows, with a description of how the investment income is to be used:

	<b>2008</b>	<b>2007</b>
Medical education	\$ 2,249	\$ 216
Clinical/patient support	136	201
Capital improvements	1,647	3,590
	<u>\$ 4,032</u>	<u>\$ 4,007</u>

The Network is an income beneficiary of certain irrevocable trusts. The aggregated income from these trusts was \$389 and \$308 for the years ended December 31, 2008 and 2007, respectively.

# **Community Health Network, Inc. and Affiliates**

## **Notes to Consolidated Financial Statements (in 000's)**

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#### **13. Commitments and Contingencies**

##### **Community Hospital of Anderson and Madison County**

On August 9, 1996, Community entered into an affiliation agreement with CHA. The agreement provides that if Community merges, affiliates, or is acquired by another health care organization, Community must deposit \$31.9 million into a foundation to fund health care programs and initiatives in Madison County, Indiana.

##### **Pending Litigation and Medical Malpractice Insurance Coverage**

Claims for employment matters, medical malpractice and breach of contract have been asserted against the Network by various claimants, and provision for such claims is made in the financial statements when management considers the likelihood of loss from the contingency to be probable and reasonably estimable. The claims are in various stages of processing and some will ultimately be brought to trial. There are known incidents occurring through December 31, 2008 that may result in the assertion of additional claims, and other claims may be asserted arising from services provided to patients in the past.

The Network is in compliance with the Indiana Medical Malpractice Act which limits the amount of recovery to \$1,250 for individual malpractice claims, \$250 of which would be paid by the Network and the balance being paid by the State Patient Compensation Fund. Management believes the ultimate disposition of existing medical malpractice and other claims will not have a material effect on the consolidated financial position or results of operations of the Network.

##### **Purchase Commitments**

As of December 31, 2008, the Network had purchase commitments for various equipment and services of \$81,172.

#### **14. Community Benefits (unaudited)**

Community Health Network defines community benefit as a planned, managed, organized, and measured approach to a health care organization's participation in meeting identified community health needs, particularly of the poor and other underserved groups by improving health status and quality of life.

Community Health Network segregates its community benefits into benefits for the poor and benefits for the community.

Benefits for the poor include traditional charity and unpaid cost of Medicaid and other indigent care programs. Traditional charity care includes free or discounted health and health-related services provided to persons who cannot afford to pay. Unpaid cost of Medicaid and other indigent care programs represents the uncompensated cost of services provided to persons covered by public programs for the poor.

Benefits for the community include unpaid cost of Medicare and other community benefits. Unpaid cost of Medicare represents the uncompensated cost of services provided to persons covered by the Medicare program. Other community benefit represents activities or services to improve community health.



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The net cost to the Network of providing benefits for the poor and the community is as follows:

	2008	2007
<b>Benefits for the poor</b>		
Traditional charity care	\$ 23,349	\$ 10,589
Unpaid cost of Medicaid and other indigent care programs	43,337	49,389
	<u>66,686</u>	<u>59,978</u>
<b>Benefits for the community</b>		
Unpaid cost of Medicare	133,446	106,529
Other community benefits	2,660	1,230
	<u>136,106</u>	<u>107,759</u>
Total community benefits	<u>\$ 202,792</u>	<u>\$ 167,737</u>

The benefits provided are measured at total cost net of any offsetting revenues or subsidy payments received.

Charges forgone for services and supplies furnished under the Network's charity care policy approximated \$53,462 and \$23,811 for the years ended December 31, 2008 and 2007, respectively. Charity care cost was determined based on the application of the associated cost-to-charge ratios to charges.

Costs forgone for services and supplies furnished under the Network's uninsured discount policy approximated \$ 4,568 and \$ 6,291 for the years ended December 31, 2008 and 2007, respectively. Uninsured discounts represent a standard discount on charges as it relates to patients who have no insurance coverage. Uninsured discount cost was determined based on the application of the associated cost-to-charge ratios to charges.

Total community benefits were 17.25% and 14.73% of total operating expenses in 2008 and 2007, respectively.